Arizona Corporation Commission
DOCKETED

JUN 22 1998

DOCKETED BY C.M.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

JIM IRVIN
COMMISSIONER - CHAIRMAN
RENZ D. JENNINGS
COMMISSIONER
CARL J. KUNASEK
COMMISSIONER

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. RE-00000C-94-0165

DECISION NO. 60977

**OPINION AND ORDER**

| | |
|---|---|
| DATES OF HEARING: | December 9, 1997 and February 5, 1998 (Procedural Conferences); February 9, 10, 11, 12, 13, 17, 18, 19, 20, 23, 25, 26 and 27, 1998 |
| PLACE OF HEARING: | Phoenix, Arizona |
| PRESIDING OFFICER: | Jerry L. Rudibaugh |
| IN ATTENDANCE: | Renz D. Jennings, Commissioner<br>Carl J. Kunasek, Commissioner |
| APPEARANCES: | Mr. Steven M. Wheeler, Mr. Thomas L. Mumaw and Mr. Jeffrey B. Guldner, SNELL & WILMER, LLP, on behalf of Arizona Public Service Company; |
| | Ms. Deborah R. Scott and Ms. Teena Wolfe, on behalf of the Residential Utility Consumer Office; |
| | Mr. Raymond S. Heyman, ROSHKA, HEYMAN & DEWULF, P.C., and Mr. Bradley S. Carroll, on behalf of Tucson Electric Power Company; |
| | Mr. Craig A. Marks, on behalf of Citizens Utilities Company; |
| | Mr. Lex J. Smith, BROWN and BAIN, P.A., on behalf of Ajo Improvement Company, Morenci Water and Electric Company, and Phelps Dodge Corporation; |
| | Mr. Michael M. Grant, GALLAGHER & KENNEDY, on behalf of Arizona Electric Power Cooperative, Graham County Electric Cooperative, and Duncan Valley Electric Cooperative; |
| | Mr. Walter W. Meek, President, on behalf of Arizona Utility Investors Association; |
| | Mr. Norman J. Furuta, on behalf of the Department of the Navy; |

Ms. Betty Pruitt on behalf of Arizona Community Action Association;

Mr. C. Webb Crockett and Mr. Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Cyprus Climax Metals, Co., ASARCO, Inc., and Arizonans for Electric Choice and Competition;

Mr. Robert S. Lynch on behalf of Arizona Transmission Dependent Utility Group;

Mr. Douglas C. Nelson and Mr. Michael B. Day, GOODIN, MACBRIDE, SQUERI, SCHLOTZ & RITCHIE, LLP, on behalf of Electric Competition Coalition, Enron Corporation and Enron Energy Services, Inc.;

Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, on behalf of PG&E Energy Services and Arizona School Boards Association;

Ms. Barbara Sherman and Ms. Marcia Weeks on behalf of Arizona Consumers Council;

Ms. Suzanne M. Dallimore, Antitrust Unit Chief, on behalf of the Arizona Attorney General's Office;

Ms. Loretta Humphrey, Civil Division, on behalf of the City of Tucson;

Mr. William P. Sullivan, MARTINEZ & CURTIS, P.C., on behalf of Navopache Electric Cooperative;

Ms. Elizabeth S. Firkins on behalf of International Brotherhood of Electrical Workers, L.U. #1116;

Mr. Carl Dabelstein in pro persona;

Mr. Myron L. Scott on behalf of Arizonans for a Better Environment;

Mr. Andrew W. Bettwy on behalf of Southwest Gas Corporation; and

Mr. Paul A. Bullis, Chief Counsel, Mr. Christopher C. Kempley, Assistant Chief Counsel and Ms. Janice M. Alward, Staff Attorney, on behalf of the Utilities Division of the Arizona Corporation Commission.

**BY THE COMMISSION:**

The Arizona Corporation Commission ("Commission") issued Decision No. 59943, dated December 26, 1996, which approved new rules, A.A.C. R14-2-1601 through R14-2-1616 ("Rules" or "Electric Competition Rules"). On August 29, 1997, the Commission issued Decision No. 60351, in which the Hearing Division was directed "to produce procedural orders in order to establish hearings, evidentiary or otherwise, regarding any aspect of electric competition that is necessary and appropriate."

On October 30, 1997, the Residential Utility Consumer Office ("RUCO") filed a Request for Evidentiary Hearing and Procedural Order ("Request for Hearing"). On November 21, 1997, Tucson Electric Power Company ("TEP") filed a Response in support of RUCO's Request for Hearing. On November 21, 1997, Citizens Utilities Company ("Citizens") filed a Statement in support of RUCO's Request for Hearing.

On November 13, 1997, ASARCO Incorporated, Cyprus Climax Metal Corporation and Enron Corporation filed their Objection to RUCO's Request. On November 15, 1997, the Electric Competition Coalition filed its Objection to RUCO's Request.

The Electric Competition Rules created several working groups that were required to generate reports regarding various aspects of the transition to competition. On September 30, 1997, the Stranded Cost Working Group ("Group") filed its Report with the Commission. The Group provided an oral presentation to the Commission on November 25, 1997.

Pursuant to Decision No. 60351 and A.A.C. R14-3-109, our December 1, 1997 Procedural Order set an evidentiary hearing on generic issues related to stranded costs and scheduled a December 9, 1997 Procedural Conference. The following were participants in the December 9, 1997 Procedural Conference and were designated as parties in this matter:

Arizona Electric Power Cooperative ("AEPCO")
Arizona Community Action Association ("ACAA")
Ft. Huachuca ("FTH")
State of Arizona, Attorney General's Office ("Attorney General")
Safford, Wickenburg Irrigation & Electric District
Salt River Project Agricultural Improvement and Power District ("SRP")[1]
Irrigation and Electrical District of Arizona
PG&E Energy Services ("PG&E")

---

1 Subsequently, SRP withdrew from the proceeding.

Arizona Utility Investors Association ("AUIA")
Morenci Water & Electric., Ajo Improvement Co ("Morenci" and "Ajo")
Residential Utility Consumer Office
Citizens Utilities Company
City of Tucson
Arizona Public Service Company ("APS")
Tucson Electric Power Company
Cyprus Climax Metals Co. ("Cyprus")
Electric Competition Coalition
Arizonans for Electric Choice and Competition
Enron Corporation ("Enron")
ASARCO Incorporated
Staff of the Arizona Corporation Commission ("Staff")

The following additional entities requested and were granted intervention:

Goldwater Institute
Land and Water Fund
Mohave Electric Cooperative, Inc.
Navopache Electric Cooperative, Inc.
Arizona Consumers Council
BHP Copper, Inc.
Mr. Carl Dabelstein
Arizona Municipal Power Users' Association
City of Phoenix
Arizonans for a Better Environment
Arizona Transmission Dependent Utility Group ("Utility Group")
Southwest Gas Corporation
Trico Electric Cooperative, Inc.
Sulphur Springs
Graham County Electric Cooperative, Inc.
Duncan Valley Electric Cooperative, Inc.
City of Scottsdale
Arizona School Boards Association ("School Board")
PacificCorp
Center for Energy and Economic Development
International Brotherhood of Electrical Workers ("IBEW")
Phelps Dodge
Department of the Navy on behalf of the Department of the Defense ("Department of Defense")

The following parties appeared and presented evidence at the hearing: Citizens; ACAA; IBEW; TEP; Enron; City of Tucson; Department of Defense; PG&E; Electric Competition Coalition; Goldwater Institute; Land and Water Fund; Utility Group; Carl Dabelstein; RUCO; AEPCO; Navopache; Arizonans for Electric Choice and Competition; Arizona Consumers Council; APS; School Board; Attorney General; Staff; and AUIA. At the conclusion of the hearing, the matter was taken under advisement pending submission of Opening Briefs on March 16, 1998 and Reply Briefs on March 23, 1998 and the issuance of a Recommended Opinion and Order to the Commission.

**DISCUSSION**

Introduction

Pursuant to Decision No. 59943, the Commission approved a phase-in transition to a competitive generation electric power market commencing on January 1, 1999. In the long-run, it is believed that competition will result in lower prices, better service, more choices and increased innovation. However, the transition from regulated monopoly to a competitive market has raised some contentious issues. One of the primary issues is who should pay for the costs associated with the transition from a cost-based regulated environment to a market environment. The Affected Utilities[2] have claimed a reliance on building large baseline generation plants/long-term power contracts to provide electric service for all those who desired service for a promise of regulated returns over the life of the plant. This is in conflict with market priced rates, especially during a period of excess generation capacity in the Southwest Region. According to APS, there will be excess capacity up through 2006. The difference between market based prices and the regulated cost of power has been generally referred to as "stranded costs". Rates that customers pay today include 100 percent recovery of stranded costs. These stranded costs consist of the following general categories: Generation related assets; Regulatory assets; and Social costs.

Pursuant to the Electric Competition Rules, the Group developed recommendations for the analysis and recovery of stranded costs. The Group held its initial meeting on March 4, 1997. There were several other meetings held during 1997, culminating in a Working Group Report on September 30, 1997. Because of the complexity of the stranded cost issue as well as the diversity of interests, there was little consensus reached by the Group. As a result, an evidentiary hearing was established to address the stranded costs issues.

---

[2] Pursuant to R14-2-1601(1), "Affected Utilities" means the following public service corporations providing electric service: Tucson Electric Power Company, Arizona Public Service Company, Citizens Utilities Company, Arizona Electric Power Cooperative, Trico Electric Cooperative, Duncan Valley Electric Cooperative, Graham County Electric Cooperative, Mohave Electric Cooperative, Sulphur Springs Valley Electric Cooperative, Navajo Electric Cooperative, Ajo Improvement Company, and Morenci Water and Electric Company.

Our December 1, 1997 Procedural Order, as amended by our December 11, 1997 Procedural Order, set forth nine issues to be resolved at this time:

1. Should the Electric Competition Rules be modified regarding stranded costs, if so, how?

2. When should "Affected Utilities" be required to make a "stranded cost" filing pursuant to A.A.C. R14-2-1607?

3. What costs should be included as part of "stranded costs" and how should those costs be calculated?

   Sub-Issue No. 3(A): What calculation methodology is recommended, and what assumptions are made including any determination of market price?

   Sub-Issue No. 3(B): Are there any implications of the Statement of Financial Accounting Standards No. 71 resulting from the recommended stranded cost calculation and recovery methodology?

4. Should there be a limitation on the time frame over which "stranded costs" are calculated?

5. Should there be a limitation on the recovery time frame for "stranded costs"?

6. How and who should pay for "stranded costs" and who, if anyone, should be excluded from paying for stranded costs?

7. Should there be a true-up mechanism and, if so, how would it operate?

8. Should there be price caps or a rate freeze imposed as part of the development of a stranded cost recovery program and if so, how should it be calculated?

9. What factors should be considered for "mitigation" of stranded costs?

All of these questions are generally inter-related to the primary issue of how much, if any, of stranded costs should be collected by the Affected Utilities. That issue can be divided into what methodology should be used in calculating stranded costs and how much of those costs should be recovered by the Affected Utilities. Further, we believe Question Nos. 3, 4, 5 and 9 go directly to those issues. As a result, we will initially focus on the following Questions:

Question No. 3: What costs should be included as part of "stranded costs" and how should those costs be calculated?

Question No. 4. Should there be a limitation on the time frame over which "stranded costs" are calculated?

Question No. 5. Should there be a limitation on the recovery time frame for "stranded costs"?

Question No. 9. What factors should be considered for "mitigation" of stranded costs?

There were a variety of recommendations both as to the method of calculating stranded costs as well as the percentage of stranded costs to be recovered by the Affected Utilities. Generally the methodologies fell into two broad categories: Administrative and Market.

The Administrative Category was represented by the Net Lost Revenues approach and the Replacement Cost Valuation approach. The Net Lost Revenues approach compares the future annual generation revenue requirement for the Affected Utility in a competitive market place to the annual requirement under the traditional regulated market. One of the main advantages cited is that it can be periodically trued-up to reflect changes.[3] A disadvantage cited was the difficulty of estimating future market prices. The Replacement Cost Valuation approach compares existing generation assets of the Affected Utilities with the most cost-effective technology available today. An advantage is that it estimates the stranded costs over the life of the assets. A disadvantage is that there is no opportunity for a true-up to correct any erroneous assumptions.

The Market Category was represented by the Auction and Divestiture approach and the Stock Market approach. The Auction and Divestiture approach would require the Affected Utilities to auction off their generation assets and compare the value received to the net book value of the assets to determine stranded costs. An advantage is that no estimation is required. A disadvantage is the various restrictions that have to be overcome to sell the generation assets. The Stock Market approach requires a new stock class to be formed which would give holders a claim against any stranded costs to be recovered. An advantage is that it does not require any true-up. A disadvantage is that there is no assurance that the stock valuation will have any relationship to stranded costs.

While the parties disagreed on the methodology to compute stranded costs, there was even more disagreement as to how much, if any, of the stranded costs should be collected by the Affected Utilities. The computation methodologies were generally tied to a mitigation recommendation. For example, most of the parties advocating the Auction and Divestiture Approach also recommended that Affected Utilities not be allowed stranded cost recovery unless they followed the Auction and Divestiture Approach.

---

[3] There were a variety of advantages and disadvantages given for all the categories. For discussion purposes, only one advantage and disadvantage is listed for each of the categories.

Some parties recommended the Affected Utilities do all possible mitigation first and then the amount of stranded costs will be determined. There were a variety of proposals that would result in a sharing of stranded costs between customers and shareholders, the rationale being that the best mitigation incentive is for the Affected Utilities to be at risk for a portion of the stranded costs. The Affected Utilities indicated that they have already put forth major mitigation efforts as evidenced by rate reductions over the last several years.

<u>Analysis</u>

In analyzing the various proposals and the evidence in support of those proposals, we conclude there are several primary objectives which must be taken into consideration in deciding the overall stranded cost issue. Those primary objectives are as follows:

A. Provide the Affected Utilities a reasonable opportunity to collect 100 percent of their unmitigated stranded costs;

B. Provide incentives for the Affected Utilities to maximize their mitigation effort;

C. Accelerate the collection of stranded costs into as short of a transition period as possible consistent with other objectives;

D. Minimize the stranded cost impact on customers remaining on the standard offer;

E. Don't confuse customers as to the bottom line; and

F. Have full generation competition as soon as possible.

Our first listed objective is to provide the Affected Utilities a reasonable opportunity to collect 100 percent of unmitigated stranded costs. We note that this is consistent with the results in the majority of other states that have decided this issue. Based on past commitments/investments, the Affected Utilities have sunk costs which would be stranded if they exceed market prices. This is not surprising since technology has continued to improve over time resulting in more efficient generation units. Additionally, there are social costs imposed on regulated entities as well as reserve requirements, all of which add to the regulated costs. The Commission has in previous rate cases determined those portions of generation assets which were prudently incurred. In hindsight, some of the managerial decisions may not have been prudent based on subsequent changes in technology. However, we do not find it appropriate to reconsider previous management decisions which the Commission determined were prudent at the time they were made. While we find the Affected Utilities should have a reasonable opportunity to collect 100 percent of unmitigated stranded costs, we want to emphasize that there is no guarantee just as there is no guaranteed recovery under traditional regulation.

It is our second objective to have an incentive that will result in a maximum mitigation effort by the Affected Utilities. Based on the testimony, we believe there should be some type of sharing of stranded costs between ratepayers and shareholders. Further, any sharing percentage would be determined prior to mitigation. Some of the parties had recommended the utilities be required to make every feasible mitigation effort possible and then share the remaining stranded costs. Clearly, that would not provide the Affected Utilities with an opportunity to collect 100 percent of stranded costs but only a pre-established percentage. We believe it is more equitable to establish a method of sharing and then as an incentive the Affected Utilities keep the subsequent mitigation savings.

We believe that divestiture of an Affected Utility's generation units would represent a significant mitigation measure, at least based on testimony that recent auctions of generating units in other states have resulted in sales at substantially in excess of book value. For Affected Utilities that do not choose to divest their generation assets, the best incentive to mitigate is for the Commission to create a risk that not all stranded costs will necessarily be recoverable.

Our third objective is to minimize the duration of the transition period consistent with other objectives. Generally, most of the parties recommended a transition period somewhere between three to six years. It was also generally recognized that the time period will have to have some flexibility in order to take into account our other listed objectives. A longer transition period will result in a reduced annualized stranded cost amount.

The next listed objective is to minimize the stranded cost impact on the customers that remain on the standard offer. One of the main concerns expressed over and over by various consumer groups was that the small consumers would end up with higher costs during the transition phase and all the benefits would flow to the larger users. At the time of the hearing, there had been minimal participation in California by residential customers in the competitive electric market place. It is not the Commission's intent to have small consumers pay higher short-term costs in order to provide lower costs for the larger consumers. Accordingly, we will place limitations on stranded cost recovery that will minimize the impact on the standard offer.

We have included the objective regarding confusion because of the results in other states. There appears to have been some confusion whereby customers were told their rates were going down when, in fact, if stranded costs were taken into consideration, the customers total bill actually increased. It is the Commission's intent that customers of the Affected Utilities be given the bottom line results of stranded costs. It should not be called a decrease unless it is a decrease on the overall bill. It also must be understood that a short transition period and rate reductions are in direct contradiction.

Lastly, it is the Commission's intent that individual stranded cost proceedings occur as quickly as possible in order to provide an opportunity for full generation competition as soon as possible. Most of the participants recommended the Affected Utilities file their individual stranded cost requests as soon as possible. The proposed time periods ranged from filing before the end of the hearing (City of Tucson) to within 120 days of the date of this Decision (TEP). Because of the January 1, 1999 deadline for commencement of the initial phase for competition, it is imperative that the earliest possible date for filing of individual stranded costs be set. The Affected Utilities have indicated stranded cost filings cannot be made without the additional guidance from this Decision. As a result, we find a reasonable deadline for stranded cost filings by each Affected Utility to be no later than 60 days from the date of this Decision.

The conflict between the aforementioned objectives is the reason the stranded cost issue was contentious. At first blush, California appears to have satisfied all these objectives simultaneously. However, what has been declared as a rate reduction disappears when the securitization portion of the California plan is taken into consideration. Securitization does have the effect of reducing the annual transition charge by spreading it over a much longer period of time.

As previously noted, we find the Affected Utilities should have a reasonable opportunity to collect 100 percent of their stranded costs. Although we cannot go so far as to agree with those parties who advocate that no stranded cost recovery should be allowed for Affected Utilities that do not divest, we do believe that the opportunity for full stranded cost recovery should be available only to those Affected Utilities that choose to divest. For Affected Utilities who do not divest, it is appropriate for the Commission to devise a different approach to deal with a particular set of circumstances. Depending on the situation of given Affected Utility, it may be in the public interest to authorize revenues sufficient to maintain financial integrity, such as avoiding default under currently existing financial instruments during a transition period, or for the Commission to otherwise provide an allocation of stranded costs responsibilities and risks between ratepayers and shareholders.

Whatever stranded costs are authorized for recovery for a given Affected Utility, all Affected Utilities are nevertheless expected to make all reasonable efforts to mitigate stranded costs. We recognize there are certain stranded costs which are more difficult to mitigate for which the Affected Utilities should have more of a guarantee than other stranded costs. We find that social costs such as low-income programs, DSM and renewable programs that have been approved by the Commission should be 100 percent recovered. Pursuant to A.A.C. R14-2-1608 those costs are to be collected annually as system benefit charges and as such are not considered stranded costs. Because of the difficulty of mitigating regulatory assets as well as the possible financial implications[4], we believe they also should be given an assured recovery. These are costs which would have been charged as expenses in a previous period absent an implicit promise by the Commission that they be deferred as an asset and collected from ratepayers in the future.

Based on the variety of financial conditions, types and amounts of stranded costs as well as shareholder/customer relationships, we find that no one methodology will fit all Affected Utilities. As a result, we will allow each Affected Utility to choose from two options: Option No. 1 - Divestiture/Auction Methodology; or Option No. 2 - Transition Revenues Methodology. These options are described below:

<u>Option No. 1 - Divestiture/Auction Methodology</u>

> The first option is to determine the amount of stranded costs by divesting/auctioning off all generation assets. In addition to the stranded costs defined by A.A.C. R14-2-1601.8, reasonable costs (i.e., costs incurred only after all reasonable efforts at minimization have been undertaken) incurred for premiums, penalties or other payments necessary to effect divestiture; income tax ramifications of divestiture; redemption costs associated with tax-exempt two-county debt which may have to be redeemed upon transfer of the assets (on-going increased debt costs will be eligible for recovery through tariffed rates); and other such reasonable costs necessarily incurred to effectuate divestiture, shall be recoverable as stranded costs. Unmitigated stranded costs shall also include reasonable employee severance and retraining costs necessitated by electric

[4] A decision that results in significant write-offs of regulatory assets could seriously impair the financial integrity of an Affected Utility.

competition, where not otherwise provided.

Each Affected utility choosing divestiture must, no later than October 1, 1998, file a divestiture plan for Commission approval. Divestiture must be completed no later than January 1, 2001. Generation assets of Affected Utilities will be sold at divestiture auctions. No Affected Utility may bid on its generation assets being auctioned. However, an Affected Utility's generation affiliate may bid on and acquire the generation assets of its parent or sister company, or the generation assets of another Affected Utility, subject to the following conditions: No entity or its affiliate(s) may purchase generation assets at any divestiture auction unless it is the highest bidder and the acquisition will not result in the entity (including any of its affiliates) having more than 40 percent of state's total generation megawatts of capacity. An Affected Utility that divests all its generation costs to non-affiliated entities, that results in negative stranded costs (not including regulatory assets) as defined by the Commission's Retail Electric Competition Rules and this Order, shall be entitled to keep 50 percent of the negative stranded costs.

An Affected Utility shall be permitted to collect 100 percent of its stranded costs, including a return on its unamortized balance, over a ten year period. The Commission will work with the Affected Utility to provide sufficient assurances in order to avoid triggering write-offs. If the stranded cost amount is determined to be negative, ratepayers shall be entitled to receive 100 percent through a refund, negative surcharge, or other mechanism as approved by the Commission. All customers of the Affected Utility shall pay their appropriate share of stranded costs through a CTC, or a standard offer rate. Stranded cost or other transition revenues authorized by the Commission shall be collected over no longer than ten years.

Option No. 2 - Transition Revenues Methodology

The second option would be to provide sufficient revenues necessary to maintain financial integrity, such as avoiding default under currently existing financial instruments for a period of ten years, at the end of which time there would be no remaining stranded costs, or for the Commission to otherwise provide an allocation of stranded cost responsibilities and risks between ratepayers and shareholders as is determined to be in the public interest for a given Affected Utility.

Individual Stranded Cost Filings

Within sixty days of the date of this Decision, each of the Affected Utilities shall file its choice of options for stranded cost recovery. In addition, the Affected Utility will need to file an implementation plan that would include the following items if appropriate for their option choice: the estimation of stranded costs separated out into regulatory assets and other generational related assets; a preliminary plan for auction/divestiture; the minimum financial ratios to maintain financial viability for ten years; the amount of regulatory assets requested, how much of those assets are generation related, and the Commission Decision No. that approved such assets; and other information as necessary.

<u>Question No. 1:</u> <u>Should the Electric Competition Rules be modified regarding stranded costs, if so, how?</u>

The majority of the parties did not believe the Rules need any significant modifications. However, most parties recommended some minor modification/clarifications.

A.A.C. R14-2-1601(8) ("Rule 1601(8)") contains the following stranded cost definition:

*<u>R14-2-1601(8)</u>*:

8. "Stranded Cost" means the verifiable net difference between:

a. The value of all the prudent jurisdictional assets and obligations necessary to furnish electricity (such as generating plants, purchased power contracts, fuel contracts, and regulatory assets), acquired or entered into prior to the adoption of this Article, under traditional regulation of Affected Utilities; and

b. The market value of those assets and obligations directly attributable to the introduction of competition under this Article.

In general, the Affected Utilities were of the opinion that some post-1996 costs should be fairly included as stranded costs. For that reason, most of the Affected Utilities requested the phrase "acquired or entered into prior to the adoption of the Article" should be deleted. Other parties filed opposition to such a change.

We believe there does need to be a reasonable cutoff period for stranded costs and the approval date of the Electric Competition Rules is a reasonable cutoff. While the Affected Utilities may have additional costs related to transactions in implementing electric competition, those costs, if reasonable, can be factored into the market price. For clarification, the following should be added after "adoption of this Article"; "or after the adoption of this Article if approved by the Commission". In addition, as stated above, the Rule should be clarified that additional costs may also be included in stranded costs, such as costs related to divestiture or to retraining of workers whose jobs are lost because of competition, and costs related to or resulting from divestiture.

A.A.C. R14-2-1607 ("Rule 1607") provides guidance for the recovery of stranded costs. Rule 1607(A) reads as follows:

*R14-2-1607(A):*

A. The Affected Utilities shall take every feasible, cost-effective measure to mitigate or offset Stranded Cost by means such as expanding wholesale or retail markets, or offering a wider scope of services for profit, among others.

In general, all the Affected Utilities opposed the requirement to take "every feasible, cost-effective measure to mitigate . . . such as expanding wholesale or retail markets. . . ." According to the Affected Utilities, a more appropriate requirement would be to "make reasonable efforts to mitigate avoidable stranded costs". Further, the Affected Utilities opined that any mitigation should not include revenues from unrelated activities to offset stranded costs.

While it was the Commission's intent for the Affected Utilities to aggressively pursue mitigation efforts, we recognize it is virtually impossible to identify every "feasible cost effective measure". As a result, we agree that Rule 1607 needs to be clarified by replacing "feasible" with "reasonable". As to the request to not include revenues from unrelated activities, we believe no clarification is necessary since the Commission is limited in its jurisdiction.

Rule 1607(B) reads as follows:

*R14-2-1607(B):* The Commission shall allow recovery of unmitigated Stranded Cost by Affected Utilities.

Several of the non-Affected Utilities requested that Rule 1607(B) be clarified to provide that Affected Utilities will be afforded an opportunity (not a guarantee) to recover legitimate unmitigated stranded costs. There was also a request that Rule 1607(B) be clarified to provide that any stranded cost recovery would commence with the introduction of retail competition.

In reading the Rules as a whole, we believe it is already clear that stranded cost recovery will commence with the introduction of retail competition. We also believe that a reading of the Rules in their entirety places the burden on the Affected Utility to demonstrate they have aggressively pursued mitigation efforts. As a result, the Affected Utility has a high burden of proof regarding its mitigation efforts. If such burden is not met, then the Affected Utility should not be allowed carte blanche recovery. Even the Affected Utilities acknowledged during the hearing that they did not want a guarantee but only a reasonable opportunity for recovery of legitimate unmitigated stranded costs. Accordingly, we will modify Rule 1607(B) by inserting the words "a reasonable opportunity for" after the word "allow".

*R14-2-1607(G):*

> G. The Affected Utilities shall file estimates of unmitigated Stranded Cost. Such estimates shall be fully supported by analyses and by records of market transactions undertaken by willing buyers and willing sellers.

PG&E requested Rule 1607(G) be modified to provide an explicit date for Affected Utilities to file estimates of unmitigatable stranded costs. Electric Choice proposed Rule 1607(G) be modified to provide that stranded cost estimates be filed at least eight months prior to the date of commencement of recovery.

As previously discussed, each Affected Utility is being ordered to filed its choice of options for stranded cost recovery along with a detailed plan which will include stranded cost estimates. Accordingly, we do find it necessary to change Rule 1607(G).

*R-14-2-1607(I):*

A.A.C. R14-2-1607(I) ("Rule 1607(I)") lists various factors to consider in determining the magnitude of stranded costs. AEPCO proposed a prudence exclusion be added to Rule 1607(I). According to AEPCO, such an exclusion will avoid time consuming debate over issues which have previously been settled. AEPCO's proposed language is as follows: "The prudence of an Affected Utilities' investment prior to the effective date of this article which the Commission had a reasonable opportunity to evaluate shall not be at issue in the stranded cost determination."

It is not the Commission's intent to go back and revise previous prudency determinations. This does not mean that the Commission may not consider changed circumstances and resulting management decisions subsequent to previous prudency determinations. The Commission does not find it necessary to list a new factor as part of Rule 1607(I) at this time.

A.A.C. R14-2-1607(J) ("Rule 1607(J)") provides guidance as to who stranded costs may be recovered from:

*R14-2-1607(J):*

> J. Stranded Cost may only be recovered from customer purchases made in the competitive market using the provisions of this Article. Any reduction in electricity purchases from an Affected Utility resulting from self-generation, demand side management, or other demand reduction attributable to any cause other than the retail access provisions of this Article shall not be used to calculate

or recover any Stranded Cost from a consumer.

PG&E requested Rule 1607(J) be clarified to indicate that stranded costs are recoverable from all retail generation customers who remain connected to the transmission and distribution systems regardless of the source of power. APS requested a similar clarification and proposed deletion of the first sentence starting with "Stranded Cost may". AEPCO proposed all language after "customer" be deleted.

It was the Commission's intent in Rule 1607(J) to make sure customers on the standard offer were not charged stranded costs as part of a transition charge in addition to an identical allocation as part of the standard offer. As a result, all customers connected to the transmission and distribution systems will be paying a share of stranded costs in some form but there will be no double charge allowed. We do not find that any change is necessary to Rule 1607(J).

A.A.C. R14-2-1608 ("Rule 1608") provides guidance on what can be collected as a system benefit charge.

*R14-2-1608:*

A. By the date indicated in R14-2-1602, each Affected Utility shall file for Commission review non-bypassable rates or related mechanisms to recover the applicable pro-rata costs of System Benefits from all consumers located in the Affected Utility's service area who participate in the competitive market. In addition, the Affected Utility may file for a change in the System Benefits charge at any time. The amount collected annually through the System Benefits charge shall be sufficient to fund the Affected Utilities' present Commission-approved low income, demand side management, environmental, renewables, and nuclear power plant decommissioning programs.

According to APS, nuclear fuel disposal costs are an inherent part of nuclear decommissioning costs which are recoverable through the System Benefits charge. As a result, APS requested Rule 1608(A) be clarified to specifically include the recovery of nuclear disposal costs. ACAA and RUCO proposed that nuclear fuel disposal and decommissioning charges are directly related to generation and as a result should be part of stranded costs not system benefits.

We concur with APS that nuclear fuel disposal costs are an inherent part of nuclear discommissioning costs. Further, for public health and public safety reasons we do not believe these should be lumped in with stranded costs. We believe Rule 1608(A) is clear without the change proposed by APS.

Question No. 3: What are the Implications of FAS 71?

The Affected Utilities must prepare their public financial statements in accordance with Statement of Financial Accounting Standard No. 71, Accounting for the Effects of Certain Types of Regulation ("FAS 71"). Pursuant to FAS 71, the Commission can create an asset by deferring, for future recovery, a current cost that would otherwise be charged to expense. These are referred to as regulatory assets and may continue to be reflected on a utility's books and financial statements as long as the following criteria are met: 1) It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in rates; and 2) Based on available evidence, future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

According to the Affected Utilities, the financial community is looking for assurances from the Commission that the Affected Utilities will be provided a return on and return of their investments. Without such assurances, the Affected Utilities will have to write-down and/or write-off some of the investments.

Most of the parties acknowledged that regulatory assets need to be treated differently than generation assets. However, some of the non-Affected Utilities opined that accounting rules should not drive regulatory policy. We believe the stranded cost recovery mechanisms approved herein will provide the Affected Utilities sufficient revenues to enable them to recover the appropriate regulatory assets. Accordingly, there should be no necessity for write-downs and/or write-offs.

Question No. 7: Should there be a True-up Mechanism and, if so, How Would it Operate?

Most of the parties tied the need of any true-up to the stranded costs methodology they recommended. There were concerns expressed that a true-up mechanism could result in uncertainty/confusion for customers and thus inhibit competition. In general, the non-Affected Utilities believed a downward true-up mechanism was a good idea.

Of the options approved herein, Option 1 requires a true-up. In addition, Option 2 may require a true-up to the extent that the Commission authorizes recovery of a particular amount of stranded costs. The requirements of any true up mechanism should be established at the time the Commission acts on an Affected Utility's stranded cost filing.

Question No. 8: Should there be a Price Cap or Rate Freeze?

Generally, the Affected Utilities opposed any price cap or freeze. On the other hand, many of the other parties supported a price cap but not a rate freeze. Those parties representing various small consumers were especially vociferous about having some type of price cap. There was a concern that larger users would reap all the benefits of competition while the smaller users would bear the brunt of higher costs.

We share the concerns expressed by small consumer groups. If small consumers are not going to have benefits in the short run, they should not be unfairly burdened with increased rates resulting from the transition costs. While we agree that small consumers deserve some rate protection during the transition period, we are also concerned that the transition costs may require some increase. We have placed a limitation that customers on the standard offer will not receive an increase as a result of stranded costs. Any stranded costs which would result in an increase to the standard offer will have to be deferred to a future period. However, an Affected Utility can still file a rate case and request an increase for reasons other than stranded costs during the transition period.

We also share concerns that stranded costs should not be used to discourage the marketing of competitive generation. We have placed a limitation that no customer will receive a rate increase as a result of stranded costs.

Miscellaneous

A. School Board Variance/Exemption:

The School Board requested a variance/exemption for its share of any stranded costs. According to the School Board, its request should be granted because of the school funding crisis in Arizona and because it is in the public interest. Further, the School Board asserted that its proposal would not result in any cost-shifting between or within customer classifications as the economic burden would be borne by the Affected Utility or its shareholders.

Other parties opposed the School Board's request because it would result in preferential treatment which would be unlawful and if granted, the request would open the floodgates for every worthwhile enterprise to claim a similar exemption.

We do not agree with the School Board's assertion that their proposal would not result in cost shifting. Clearly, either other ratepayers and/or other shareholders would pick up the additional costs. Any solution to the School Board funding problems must be dealt with by the legislature on a state-wide basis. Accordingly, the requested variance/exemption is denied.

B. Allocation Methodology:

There were some discussions regarding the allocation methodology for stranded costs. It is the Commission's intent that all present and future customers should pay their fair share of stranded costs. As a result, we will adopt a rebuttable presumption that all customers connected to the grid should pay an appropriate amount of stranded costs consistent with the current approved rate treatment of each Affected Utility.

C. Exit Fees:

Several of the parties expressed an interest in an exit fee that would enable them to make an up-front buy out of their portion of stranded costs. We will order each Affected Utility to develop a discounted stranded costs exit methodology that a customer may choose to determine an amount in lieu of making monthly payments. The methodology should be developed with input from interested parties and approved by the Commission.

## SUMMARY

Pursuant to Decision No. 59943, the Commission committed to electric generation competition commencing on January 1, 1999. There are still details which must be resolved prior to such competition. The most contentious issue still needing to be resolved is that of stranded costs. In general, the Affected Utilities have indicated they have the right to such costs because they have followed the "rules of the game." Most of the larger consumers are saying the rules of the game have changed and the remaining baggage from the previous game is the problem of the Affected Utility. The smaller consumers aren't as concerned with the rule changes but do not want to be declared the losers before the game begins.

The Commission has attempted in this Decision to carefully balance the various concerns. As a result, we believe the Affected Utilities will have a reasonable opportunity to collect 100 percent of their stranded costs over a relatively short transition period, customers who desire to utilize a competitive generation source will have an opportunity to obtain a more favorable rate than can be obtained through the standard offer, and those customers who remain on the standard offer will not receive a rate increase as a result of stranded costs. We want to make it clear that this overall scenario is only possible through continued growth in Arizona as well as increased efficiencies by the Affected Utility. Growth will help Affected Utilities mitigate potential losses of customers to competition. At the same time, the Affected Utilities will need to continue to tighten their belts in order to bring their costs down to the market by the end of the transition period. After the Affected Utilities have collected the expenses associated with their appropriate regulatory assets, all customers remaining on the standard offer should receive a reduction in their overall rates.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

## FINDINGS OF FACT

1. The Commission issued Decision No. 59943 which approved the Electric Competition Rules.

2. Decision No. 59943 approved a phase-in transition to a competitive generation power market commencing on January 1, 1999.

3. In the long-run it is believed that competition will result in lower prices, better service, more choices, and increased innovation.

4. The Commission issued Decision No. 60351 which directed the Hearing Division "to produce procedural orders in order to establish hearings, evidentiary or otherwise, regarding any aspect of electric competition that is necessary and appropriate".

5. On September 30, 1997, the Group filed its Report to the Commission.

6. On October 30, 1997, RUCO filed a Request for Hearing.

7. Our December 1, 1997 Procedural Order set an evidentiary hearing on generic issues related to stranded costs commencing on February 9, 1998.

8. The difference between market based prices and the cost of regulated power has been generally referred to as stranded costs.

9. According to APS, there will be excess generation capacity in the Southwest Region up through 2006.

10. Stranded costs consist of the following general categories: Generation related assets; Regulatory Assets; and Social costs.

11. The September 30, 1997 Working Group Report contained little consensus on stranded cost issues.

12. Our December 1, 1997 Procedural Order, as amended by our December 11, 1997 Procedural Order, set forth nine issues to be resolved:

Question No.1. Should the Electric Competition Rules be modified regarding stranded costs, if so, how?

Question No. 2. When should "Affected Utilities" be required to make a "stranded cost" filing pursuant to A.A.C. R14-2-1607?

Question No. 3. What costs should be included as part of "stranded costs" and how should those costs be calculated?

Question No. 3A. What calculation methodology is recommended, and what assumptions are made including any determination of market price?

Question No. 3B. Are there any implications of the Statement of Financial Accounting Standards No. 71 resulting from the recommended stranded cost calculation and recovery methodology?

Question No. 4. Should there be a limitation on the time frame over which "stranded costs" are calculated?

Question No. 5. Should there be a limitation on the recovery time frame for "stranded costs"?

Question No. 6. How and who should pay for "stranded costs" and who, if anyone, should be excluded from paying for stranded costs?

Question No. 7. Should there be a true-up mechanism and, if so, how would it operate?

Question No. 8. Should there be price caps or a rate freeze imposed as part of the development of a stranded cost recovery program and if so, how should it be calculated?

Question No. 9. What factors should be considered for "mitigation" of stranded costs?

13. The methods of calculating stranded costs falls into two broad categories: Administrative and Market.

14. The Administrative Category was represented by the Net Lost Revenues approach and the

Replacement Cost Valuation approach.

15. The Market Category was represented by the Auction and Divestiture approach and the Stock Market approach.

16. Each of the categories and respective approaches have some advantages and disadvantages.

17. Rate reductions over the last several years reflect mitigation efforts put forth by the Affected Utilities in contemplation of competition.

18. Affected Utilities should have a reasonable opportunity to collect 100 percent of their unmitigated stranded costs.

19. Both regulatory assets and the costs of systems benefits should be recovered at 100 percent.

20. Traditional regulation does not guarantee 100 percent recovery of costs but only a reasonable opportunity to recover costs.

21. A longer transition period will result in a reduced annualized stranded cost amount.

22. Securitization is a financing method that can be utilized to spread stranded costs over a longer period and thus minimize the annual impact.

23. A short transition period and rate reductions are in direct contradiction.

24. Regulatory assets are costs which would have been charged as expenses in a previous period absent an implicit promise by the Commission that they be deferred as an asset and collected from ratepayers in the future.

25. No one methodology for calculating stranded costs will fit all Affected Utilities.

26. Any stranded cost recovery methodology must balance the interests of the Affected Utilities, ratepayers, and a move toward competition.

27. The Net Revenues Lost Methodology proposed by APS provides little incentive for customers to utilize another competitive service.

28. Affected Utilities should be given more of an assured recovery for regulatory assets and social costs than for other generation related stranded costs.

29. All current and future customers of the Affected Utilities should pay their fair share of

regulatory assets and social costs.

30. Arizona's population has been steadily growing.

31. Customer growth will help Affected Utilities mitigate stranded costs.

32. The stranded cost options approved herein should provide sufficient cash flow for the Affected Utilities to recover their appropriate regulatory assets.

33. Stranded cost recovery is not an opportunity to revisit prudence of previous generation asset decisions.

34. Stranded cost or other transition revenues authorized by the Commission should be collected over no longer than ten years, although particular circumstances and objectives may dictate a shorter or longer period.

35. A reasonable deadline for stranded cost filing by each Affected Utility is no later than 60 days from the date of this Decision.

## CONCLUSIONS OF LAW

1. The Affected Utilities are public service corporations with the meaning of the Arizona Constitution, Article XV, under A.R.S. §§ 40-202, -203, -250, -321, -322, -331, -332, -336, -361, -365, -367, and under the Arizona Revised Statutes, Title 40, generally.

2. The Commission has jurisdiction over the Affected Utilities and of the subject matter contained herein.

3. Notice of the proceeding has been given in the manner prescribed by law.

4. The Electric Competition Rules should be amended consistent with this Decision.

## ORDER

IT IS THEREFORE ORDERED that within 60 days of the date of this Decision, each Affected Utility as defined in A.A.C. R14-2-1601(1) shall file its choice of options for stranded cost recovery.

IT IS FURTHER ORDERED that each Affected Utility shall file an implementation plan with its stranded cost option which should set forth the details for its plan including its estimated stranded costs separated out into regulatory assets and other generation related assets.

IT IS FURTHER ORDERED that within 30 days of each Affected Utility filing its implementation plan, all other parties shall file any comments/disagreements and requests for hearing.

IT IS FURTHER ORDERED that there is a rebuttable presumption that stranded costs shall be allocated in a manner consistent with the current rate treatment for each Affected Utility.

IT IS FURTHER ORDERED that the Director of the Utilities Division shall submit rule amendments as set forth herein to the Secretary of State's office commencing the process of rule adoption on an emergency basis.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

COMMISSIONER - CHAIRMAN | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, JACK ROSE, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 22 day of June, 1998.

for JACK ROSE
EXECUTIVE SECRETARY

DISSENT

JLR:dap

SEE ATTACHED CONCURRING OPINION OF COMMISSIONER RENZ D. JENNINGS

SERVICE LIST FOR: COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO.: RE-00000C-94-165

Barbara Klemstine
ARIZONA PUBLIC SERVICE CO.
Station 9909
P.O. Box 53999
Phoenix, Arizona 85072-3999

Greg Patterson
RUCO
2828 N Central Ave, Suite 1200
Phoenix, Arizona 85004

Michael A. Curtis
MARTÍNEZ & CURTIS, P.C.
2712 North 7th Street
Phoenix, Arizona 85006
Attorneys for Arizona Municipal Power Users' Association

Walter W. Meek, President
ARIZONA UTILITY INVESTORS ASSOCIATION
2100 N. Central Avenue, Suite 210
Phoenix, Arizona 85004

Rick Gilliam
LAND AND WATER FUND OF THE ROCKIES
2260 Baseline Road, Suite 200
Boulder, Colorado 80302

Charles R. Huggins
ARIZONA STATE AFL-CIO
110 North 5th Avenue
P.O. Box 13488
Phoenix, Arizona 85002

David C. Kennedy
LAW OFFICES OF DAVID C. KENNEDY
100 West Clarendon Avenue, Suite 200
Phoenix, Arizona 85012-3525

Norman J. Furuta
DEPARTMENT OF THE NAVY
900 Commodore Drive, Building 107
P.O. Box 272 (Attn. Code 90C)
San Bruno, California 94066-0720

Thomas C. Horne
Michael S. Dulberg
HORNE, KAPLAN & BISTROW, P.C.
40 North Central Avenue, Suite 2800
Phoenix, Arizona 85004

Barbara S. Bush
COALITION FOR RESPONSIBLE ENERGY EDUCATION
315 West Riviera Drive
Tempe, Arizona 85252

Rick Lavis
ARIZONA COTTON GROWERS ASSOCIATION
4139 East Broadway Road
Phoenix, Arizona 85040

Steve Brittle
DON'T WASTE ARIZONA, INC.
6205 South 12th Street
Phoenix, Arizona 85040

Karen Glennon
19037 N. 44th Avenue
Glendale, Arizona 85308

COLUMBUS ELECTRIC COOPERATIVE, INC.
P.O. Box 631
Deming, New Mexico 88031

CONTINENTAL DIVIDE ELECTRIC COOPERATIVE
P.O. Box 1087
Grants, New Mexico 87020

DIXIE ESCALANTE RURAL ELECTRIC ASSOCIATION
CR Box 95
Beryl, Utah 84714

GARKANE POWER ASSOCIATION, INC.
P.O. Box 790
Richfield, Utah 84701

Stephen Ahearn
ARIZONA DEPT OF COMMERCE
ENERGY OFFICE
3800 North Central Avenue, 12th Floor
Phoenix, Arizona 85012

Betty Pruitt
ARIZONA COMMUNITY ACTION ASSOC.
2627 N. 3rd Street
Phoenix, Arizona 85004

Bradley Carroll
TUCSON ELECTRIC POWER CO.
P.O. Box 711
Tucson, Arizona 85702

Mick McElrath
CYPRUS CLIMAX METALS CO.
P.O. Box 22015
Tempe, Arizona 85285-2015

A.B. Baardson
NORDIC POWER
4281 N. Summerset
Tucson, Arizona 85715

Michael Rowley
c/o CALPINE POWER SERVICES
50 West San Fernando, Suite 550
San Jose, California 95113

Dan Neidlinger
3020 N. 17th Drive
Phoenix, Arizona 85015

Jessica Youle
PAB300
SALT RIVER PROJECT
P.O. Box 52025
Phoenix, Arizona 85072-2025

Clifford Cauthen
GRAHAM COUNTY ELECTRIC CO-OP
P.O. Drawer B
Pima, Arizona 85543

Joe Eichelberger
MAGMA COPPER COMPANY
P.O. Box 37
Superior, Arizona 85273

Craig Marks
CITIZENS UTILITIES COMPANY
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012

Jack Shilling
DUNCAN VALLEY ELECTRIC COOPERATIVE
P.O. Box 440
Duncan, Arizona 85534

Nancy Russell
ARIZONA ASSOCIATION OF INDUSTRIES
2025 N. 3rd Street, Suite 175
Phoenix, Arizona 85004

Barry Huddleston
DESTEC ENERGY
P.O. Box 4411
Houston, Texas 77210-4411

Steve Montgomery
JOHNSON CONTROLS
2032 West 4th Street
Tempe, Arizona 85281

ARIZONA RETAILERS ASSOCIATION
Michelle Ahlmer
137 East University Drive
Mesa, Arizona 85201-5995

Ken Saline
Jeff Woner
K.R. SALINE & ASSOCIATES
160 N. Pasadena
Suite 101
Mesa, AZ 85201-6764

Louis A. Stahl
STREICH LANG
2 North Central Avenue
Phoenix, Arizona 85004

Douglas Mitchell
SAN DIEGO GAS AND ELECTRIC CO.
P.O. Box 1831
San Diego, California 92112

Sheryl Johnson
TEXAS-NEW MEXICO POWER CO.
4100 International Plaza
Fort Worth, Texas 76109

Ellen Corkhill
AARP
5606 North 17th Street
Phoenix, Arizona 85016

Andrew Gregorich
BHP COPPER
P.O. Box M
San Manuel, Arizona

Larry McGraw
USDA-RUS
6266 Weeping Willow
Rio Rancho, New Mexico 87124

Jim Driscoll
ARIZONA CITIZEN ACTION
2430 S. Mill. Suite 237
Tempe. Arizona 85282

William Baker
ELECTRICAL DISTRICT NO. 6
P.O. Box 16450
Phoenix, Arizona 85011

John Jay List
General Counsel
NATIONAL RURAL UTILITIES
COOPERATIVE FINANCE CORP.
2201 Cooperative Way
Herndon. Virginia 21071

Wallace Tillman
Chief Counsel
NATIONAL RURAL ELECTRIC
COOPERATIVE ASSOCIATION
4301 Wilson Blvd.
Arlington, Virginia 22203-1860

Robert Julian
PPG
1500 Merrell Lane
Belgrade. Montana 59714

C. Webb Crockett
FENNEMORE CRAIG
3003 N. Central Avenue. Suite 2600
Phoenix. Arizona 85012-2913
Attorneys for Asarco. Inc., Cyprus Climax Metals Co.:
Enron. Inc. and AAEC

Department of Navy
Naval Facilities Engineering Command
Navy Rate Intervention
901 M Street SE, Building 212
Washington, DC 20374
Attn: Sam DeFrawi

Robert S. Lynch
340 E. Palm Lane, Suite 140
Phoenix, Arizona 85004-4529

Douglas A. Oglesby
Vantus Energy Corporation
353 Sacramento Street, Suite 1900
San Francisco, California 94111

Michael Block
Goldwater Institute
Bank One Center
201 North Central
Concourse Level
Phoenix, Arizona 85004

Stan Barnes
Copper State Consulting Group
100 W Washington Street. Suite 1415
Phoenix, Arizona 85003

Carl Robert Aron
Executive Vice President and COO
Itron, Inc.
2818 N. Sullivan Road\
Spokane, Washington 99216

Douglas Nelson
DOUGLAS C NELSON PC
7000 N. 16th Street. Suite 120-307
Phoenix. Arizona 85020

Lawrence V. Robertson Jr.
MUNGER CHADWICK PLC
333 North Wilmot. Suite 300
Tucson. Arizona 85711-2634
Attorney for PGE Energy

Tom Broderick
6900 East Camelback Rd. # 700
Scottsdale. Arizona 85251

Albert Sterman
ARIZONA CONSUMERS COUNCIL
2849 East 8th Street
Tucson. Arizona 85716

Michael Grant
GALLAGHER & KENNEDY
2600 N. Central Avenue
Phoenix. Arizona 85004
Attorneys for AEPCO

Suzanne Dallimore
Antitrust Unit Chief
Department of Law Building
Attorney General's Office
1275 West Washington Street
Phoenix. Arizona 85007

Lex Smith
Michael Patten
BROWN & BAIN PC
2901 N. Central Avenue
Phoenix, Arizona 85001-0400
Attorneys for Morenci Water & Electric,
Ajo Improvement & Phelps Dodge Corp.

Vinnie Hunt
CITY OF TUCSON
Department of Operations
4004 S. Park Avenue, Building #2
Tucson, Arizona 85714

Steve Wheeler
Thomas M. Mumaw
SNELL & WILMER
One Arizona Center
400 E. Van Buren Street
Phoenix, Arizona 85004-0001
Attorneys for APS

William Sullivan
MARTINEZ & CURTIS, P.C.
2716 N. 7th Street.
Phoenix, Arizona 85006
Attorneys for Mohave Electric Cooperative and
Navopache Electric Cooperative

Elizabeth S. Firkins
INTERNATION BROTHERHOODL OF
ELECTRICAL WORKERS, L.U. #1116
750 S. Tucson Blvd.
Tucson, Arizona 85716-5698

Carl Dabelstein
2211 E. Edna Avenue
Phoenix, Arizona 85022

Larry K. Udall
Arizona Municipal Power Users' Assoc.
2712 N. 7th Street
Phoenix, Arizona 85006-1090

Roderick G. McDougall
City Attorney
Attn: Jesse Sears, Assistant Chief Counsel
200 W Washington Street, Suite 1300
Phoenix, Arizona 85003-1611

William J. Murphy
200 W Washington Street, Suite 1400
Phoenix, Arizona 85003-1611

Russell E. Jones
33 N. Stone Ave., Suite 2100
P.O. Box 2268
Tucson, Arizona 85702
Attorneys for Trico Electric Cooperative, Inc.

Christopher Hitchcock
P.O. Box 87
Bisbee, Arizona 85603-0087
Attorneys for Sulphur Springs Valley
Electric Cooperative, Inc.

Myron L. Scott
1628 E. Southern Avenue, No. 9-328
Tempe, AZ 85282-2179
Attorneys for Arizona for a Better Environment

Andrew Bettwy
Debra Jacobson
SOUTHWEST GAS CORPORATION
5241 Spring Mountain Road
Las Vegas, Nevada 89102

Barbara R. Goldberg
OFFICE OF THE CITY ATTORNEY
3939 Civic Center Blvd.
Scottsdale, Arizona 85251

Terry Ross
Center for Energy & Economic Development
P.O. Box 288
Franktown, Colorado 80116

Peter Glaser
DOHERTY RUMBLE & BUTLER PA
1401 New York Ave., N.W., Suite 1100
Washington, DC 20005

Phyllis Rowe
ARIZONA CONSUMERS COUNCIL
P.O. Box 1288
Phoenix, Arizona 85001

Thomas Pickrell
Arizona School Board Association
2100 N. Central Avenue
Phoenix, Arizona 85004

Paul Bullis, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

Director Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007

# CONCURRING OPINION

NAME: Competition in the Provision of Electric Services throughout the State of Arizona

DOCKET NO. RE-00000C-94-165 OPEN MEETING DATE: June 3, 1998

PREPARED BY: Commissioner Renz D. Jennings

==================================================================

I agree with much of what Commissioner Kunasek writes in his dissenting opinion. However, I don't believe that "all generation in the state would be up for auction at the same time." Even if all affected utilities divest, there probably will be different timing for each divestiture. Moreover, there is little generation up for sale at this moment in the West and the evidence was that many might be willing to pay a premium to get a foothold in new markets. However, I disagree with his assertion that the majority decision constitutes a coerced divestiture. It simply encourages Arizona's utilities to divest by permitting them to keep 50% of the above-book proceeds should they decide to divest. Commissioner Kunasek's assertion that the Order "removes from the bid process the party most likely to bid the highest for its facilities" is flat wrong. Under my amendment to the Order, which Commissioner Kunasek voted against, generation affiliates of incumbent utilities are given the opportunity to bid on the assets of their parent or sister company.

The second purpose of my amendment is the realization that it is important in a competitive generation market to have structural separation of generation to prevent cross-subsidization. My amendment also addresses the market power problem by limiting the ownership of generation serving the Arizona market to 40% by any entity or its affiliates.

DECISION NO. 60977

# DISSENT OPINION

**COMPANY:** **In The Matter Of The Competition In The Provision Of Electric Services Throughout The State of Arizona**

**DOCKET NO.** **RE-00000C-94-0165** **OPEN MEETING DATE:** **6-3-98**

**PREPARED BY:** **Commissioner Carl J. Kunasek** CKunasek

Four years ago I ran for this office promising to deregulate Arizona's electricity market. My commitment to a deregulated market place for energy has grown stronger; however, my appreciation for the complexities of the task and its potential impact on our citizens has deepened. And while many have put this state's deregulation effort on fast forward with promises of rate reductions that may never materialize, I remain committed to an orderly process that will bring about an appropriate market structure and the chance for all Arizona citizens to benefit both early on and when the market is fully competitive.

No one should doubt my commitment to a competitive electricity market. As a legislator, I led the charge to deregulate hospitals, authored the Arizona Health Care Cost Containment System (AHCCS) program, Arizona's answer to Medicaid, and rewrote the laws pertaining to the care and treatment of mentally retarded citizens which removed the provision of state treatment to the private sector. In each of these cases every citizen of the state benefited by switching from government controlled services to services provided by the private sector on a competitive bid basis.

My commitment to deregulating Arizona's power generation market and belief that it will benefit all Arizona citizens, if done right, is no less real. My guiding principle is that all Arizona citizens must have the opportunity to benefit from this change in market structure. We must preserve the finer aspects of the regulated market (reliability and certainty of delivery) and institute a set of rules that provides choice for all Arizonans on a reasonable time line and in an orderly fashion.

For the past two years this Commission has attempted to advance the cause of deregulation by holding numerous workshops as well as hearings on stranded investment that provided all parties the opportunity to meaningfully participate in the decision making process. Much was accomplished along the way but even more needs to be done.

I continue to believe that the best hope for competition and the most beneficial result for Arizona's citizens rest with a settlement that would recognize the needs, strengths and limitations of all classes of customers. For the past 87 years consumers have had their energy decisions made for them. It is simply unrealistic to expect residential consumers to make informed beneficial decisions overnight. I do concur with staff's position that those not eligible for open access should receive some financial benefit during the time period they are held captive.

I concur with Commissioner Jennings comments (Minutes of Meeting ("MM") page 28 lines 3-12 and lines 16-24) that residential consumers are not clamoring for competition. I also believe that there will come a day when residential consumers will value choices. But that day is not today nor is it in the near future. The market must be given time to evolve and consumers must be given time to learn. What we must not do is take actions that force competition quickly, perhaps haphazardly, that results in the first taste of competition being a sour one for small consumers.

There are many issues yet to be decided. Without question the most controversial issue is stranded investment, the significance of which changes depending on the manner and timing of the transition to competition. I do not believe that these issues can be decided in a vacuum, nor do I believe that the parties can make an informed decision without knowing what comes next. I think it's very important for this Commission and all the parties to weigh the pros and cons of any proposal in context of how it fits in the overall plan. As Michael Grant indicated in his comments ( MM, page 100, line 25 through page 101, line 6) we should not be taking issues off the table at this time.

Further, given the significance of the stranded investment outcome, this Commission acts irresponsibly when it approves coerced divestiture on a one-size-fits-all approach without so much as one piece of evidence or analysis in the record that supports the general theme proffered by the majority that divestiture will reduce the amount of stranded investment that residential consumers will pay. Worse yet, divestiture could well increase the amount of stranded investment if utilities are forced to sell facilities in a market saturated with available generation.

Common sense would tell you that if all utilities avail themselves of the divestiture option that all generation in the state would be up for auction at the same time. This is similar to a homeowner trying to sell his home at the very time each of his neighbors had their home on the market. The timing of the sale would not be conducive to producing a high price at the time of sale. Additionally, the order removes from the bid process the party most likely to bid the highest for its facilities. There is simply no reason to deny incumbent utilities the opportunity to retain their assets.

Let me make it clear that I believe divestiture can be an appropriate method for dispensing with the stranded investment issue. Divestiture must not be coerced or forced. Further, we must recognize that it may not be beneficial for some utilities to divest its generation. As Commissioner Jennings indicated (MM, page 28, line 16-24), without an understanding on where this process ends, the decision to divest "may be less than optimal."

In the final analysis, the action that this Commission took in approving the stranded investment order significantly narrows our options. Further, in our haste to accelerate competition, we run the risk of slowing the transition given certain litigation. I don't think there is anyone familiar with this process that believes that the action taken by this Commission would withstand a legal challenge. This Commission is far better served to carefully evaluate and move forward proposals that will withstand judicial scrutiny so that in the end we don't inadvertently slow the process.